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No. ——

In The Supreme Court of the United States

October Term, 1993

Doctor's Associates, Inc.,
Petitioner,

v.

Dick DeWayne Cox, Jr. and
Substantial Enterprises, Inc.,
Respondents.

Petition for a Writ of Certiorari to the Appellate Court of Illinois, Fifth District

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PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Does a jury award of $1,000,000 in punitive damages violate the Due Process Clause of the Fourteenth Amendment when the jury awarded no actual damages on the claim, which arose from the defendant's legitimate efforts to protect its business and trademarks?

PARTIES TO THE PROCEEDING

The parties to case No. 5-91-0657 in the Appellate Court of Illinois, Fifth District, were Petitioner Doctor's Associates, Inc., and Respondents Dick DeWayne Cox and Substantial Enterprises, Inc.

The parties before this Court are the same as the parties below.

Petitioner Doctor's Associates, Inc. has no parent companies or subsidiaries to list pursuant to Rule 29.1.

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PETITION FOR A WRIT OF CERTIORARI

Doctor's Associates, Inc. ("DAI"), respectfully petitions for a writ of certiorari to review the judgment and opinion of the Appellate Court of Illinois, Fifth District, entered in this proceeding on May 14, 1993.

OPINIONS BELOW

The opinion of the Appellate Court of Illinois is reported at 245 Ill. App. 3d 186, 613 N.E.2d 1306, and is reprinted in the appendix ("App.") at p. 1a, *infra.*

The order of the Supreme Court of Illinois denying DAI's petition for leave to appeal is reported at 152 Ill. 2d 556, —— N.E.2d ——, and is reprinted in the appendix at p. 43a, *infra.*

JURISDICTION

The Appellate Court of Illinois issued its decision on May 14, 1993. DAI filed with the Appellate Court an affidavit of intent to seek review on June 4, 1993. DAI filed a petition for leave to appeal on June 18, 1993, which the Supreme Court of Illinois denied on October 6, 1993.

This Court has jurisdiction to review the judgment of the Appellate Court of Illinois pursuant to 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISION INVOLVED

U.S. Const. amend. XIV, § 1.

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

STATEMENT OF THE CASE

DAI is the franchisor of Subway sandwich shops. DAI licenses others to use the Subway name, trademarks, and operating system in shops throughout the country. In return, franchisees pay DAI an initial franchise fee plus periodic royalties and advertising fees based on sales at each shop.

Pursuant to the Federal Trade Commission's franchise disclosure rule, 16 C.F.R. § 436.1, DAI issues an offering circular to prospective franchisees to inform them about the nature of the business. DAI's 1987 offering circular stated, among other things: (1) that DAI would not unreasonably withhold approval of a site selected by a franchisee for opening a Subway shop; and (2) that the fran-

chisee does not have exclusive territorial rights for the market area in which the site is located.

1. The Parties' Dispute.

As of 1987, Respondent Dick DeWayne Cox and his partner, Richard Yates, owned and operated five Subway shops in Illinois. Pursuant to paragraph 5(a) of the franchise agreements, DAI's designee, Subway Sandwich Shops, Inc., leased the premises for each of the five shops and subleased to Cox and Yates. App. 63a. Cox and Yates also had purchased the rights to three additional Subway franchises for $1000 each. Cox and Yates incorporated Respondent Substantial Enterprises, Inc. ("Substantial") and purported to transfer their franchise rights to Substantial.

In late 1987, Cox and Yates approached the May Company, a mall operator, about the possibility of opening a Subway shop in the St. Clair Square Mall. May Company advised Cox and Yates to open shops at two other May Company malls—the Mid-Rivers Mall and the Alton Square Mall. May Company suggested that Cox and Yates then would be in line to open a shop at St. Clair Square.

Cox and Yates sought permission from DAI to open a shop at each of the malls. Cox testified at trial that in December 1987 DAI's resident development agent said the three mall project was a "go." In early 1988, DAI's development agent told Cox he could not proceed with the Mid-Rivers Mall site because another franchisee was operating a Subway shop across the street from the Mall. That franchisee threatened to sue DAI if a shop was opened at Mid-Rivers. DAI refused to sign a lease for the site.

Believing they had a commitment with the May Company to open sandwich shops, Cox and Yates decided to open "Sub-City" shops at the Mid-Rivers and Alton Square Malls. Cox and Yates signed leases with May

Company and opened a Sub-City shop in the Mid-Rivers Mall in May 1988.

Paragraph 5(d) of the Subway franchise agreements prohibited Cox and Yates, during the term of the agreements, from engaging in any business "identical with or similar to" a Subway sandwich shop. App. 64a. Since Cox and Yates breached that provision by opening the Sub-City shop, paragraph 5(d) required them to pay DAI $7500 plus 8% of the gross sales at the Sub-City shop. *Id.* DAI demanded payment.

DAI also refused to go forward with a sublease to Cox and Yates for a Subway site in Granite City, Illinois until the Mid-Rivers Mall dispute was resolved. DAI previously had approved the site and executed a lease on the property. DAI likewise refused to approve any additional Subway sites for Cox and Yates.

In June 1988, Cox, Yates, and Substantial filed suit against DAI. Yates later assigned his interest in the Subway franchises and the Sub-City shop to Cox and Substantial. From that time forward, Yates had no interest in this case.

In September 1988, Cox and Substantial ceased paying to DAI royalties and advertising fees for their five operating Subway shops. In a letter to counsel for DAI dated November 15, 1988, Cox asserted that DAI was "in default of the various franchise agreements, and for that reason I have terminated those franchise agreements." Cox and Substantial nevertheless continued to operate the shops under the Subway name.

The Subway franchise agreements provided that disputes related to the agreements would be settled by arbitration. App. 70a. In October 1988, DAI moved to compel arbitration.

In January 1989, Subway Sandwich Shops, Inc. filed forcible detainer actions to evict Cox and Substantial

from their five Subway shops. Those actions subsequently were consolidated with the suit by Cox and Substantial against DAI.

On February 3, 1989, the trial court denied DAI's motion to compel arbitration. The court concluded that DAI waived its right to insist on arbitration when Subway Sandwich Shops, Inc. filed the forcible detainer actions.

Cox and Substantial twice amended their complaint, which ultimately included three pertinent counts. Count I alleged that DAI breached the franchise agreements by unreasonably withholding approval of the Mid-Rivers Mall and Granite City sites, among others. Count I also alleged that DAI breached the agreements when Subway Sandwich Shops, Inc. filed the forcible detainer actions before the issue of default had been resolved in DAI's favor by arbitration or litigation. App. 47a-49a.

In Count II, Cox and Substantial sought punitive damages for "willful wanton breach of contract." Count II alleged that DAI misrepresented (1) that it would not unreasonably withhold site approval, and (2) that it would not file eviction actions until the issue of default had been decided in its favor by arbitration. Count II alleged that DAI's conduct caused Cox and Substantial "to suffer damages for breach of contract." App. 49a-50a.

Count IV alleged that DAI committed common law fraud by making the misrepresentations alleged in Count II.

DAI counterclaimed for breach of contract based on Cox and Substantial's failure to pay royalties and advertising fees at their Subway shops and their operation of a competing Sub-City shop. DAI also counterclaimed for trademark infringement and sought a permanent injunction prohibiting Cox and Substantial from operating the Subway shops.

2. Trial Proceedings.

The case went to trial in April 1991. Subway Sandwich Shops, Inc. voluntarily dismissed the forcible detainer actions against Cox and Substantial when the trial began.

Prior to closing arguments, Cox and Substantial voluntarily dismissed their common law fraud claim in Count IV. The trial court entered the dismissal with prejudice. Cox also voluntarily dismissed himself as a plaintiff, but he remained in the case as a counterclaim defendant.

After closing arguments, the court instructed the jury with respect to punitive damages: "If you decide that [DAI's] conduct was willful and wanton and proximately caused injury to the plaintiff and if you believe that justice and the public good require it, you may in addition to any damages to which you find the plaintiff entitled, award an amount which will serve to punish the defendant and to deter others from commission of like offenses." App. 55a.

On April 26, 1991, the jury awarded Substantial $200,000 in actual damages for Count I, plus $1,000,000 in punitive damages, but no actual damages, for Count II. The jury awarded DAI $258,000 on its breach of contract counterclaim and $50,000 for trademark infringement. App. 44a.

DAI filed a motion for judgment notwithstanding the verdict on May 24, 1991. Among other things, DAI argued that the punitive damage award violated the Due Process Clause of the Fourteenth Amendment.

On August 13, 1991, the trial court denied DAI's motion, entered judgment on the jury verdict, and permanently enjoined Cox and Substantial from using the Subway trademarks. Cox and Substantial filed a notice of appeal with the Appellate Court of Illinois, Fifth District, on September 10, 1991. Two days later, DAI filed a cross-appeal.

3. The Appellate Court's Opinion.

The Appellate Court affirmed on May 4, 1993. With respect to punitive damages, the Court concluded that the trial court's instructions sufficiently circumscribed the jury's discretion by identifying the purposes of punitive damages and by requiring the jury to find DAI's conduct willful and wanton. App. 34a. The Court also noted that, pursuant to Ill. Rev. Stat. ch. 735, § 5/2-1207, trial courts have discretion to reduce excessive punitive damage awards. *Id.* Based on those "safeguards," the Appellate Court held that "due process was satisfied." *Id.* at 34a-35a.

The Appellate Court agreed with DAI that "Substantial's claim for breach of contract parallels its claim for punitive damages in that the same conduct is involved in each claim." App. 39a. The Court also acknowledged the rule in Illinois that punitive damages are not recoverable for breach of contract. *Id.* at 38a. Nonetheless, the Court held that the jury properly awarded punitive damages for Count II, since DAI's alleged misrepresentations were "extraneous to the breach, amounting to an independent tort for which punitive damages could be awarded." *Id.* at 41a. The Appellate Court did not address the jury's failure to award actual damages on Count II or the legal import of the dismissal with prejudice of Substantial's common law fraud claim in Count IV.

DAI filed with the Appellate Court an affidavit of intent to seek review on June 4, 1993. DAI filed a petition for leave to appeal to the Supreme Court of Illinois on June 18, 1993. The Illinois Supreme Court denied the petition on October 6, 1993. App. 43a.

REASONS FOR GRANTING THE WRIT

THE COURT SHOULD GRANT THE PETITION TO CLARIFY DUE PROCESS LIMITS ON PUNITIVE DAMAGE AWARDS.

The punitive damage award in this case is a paradigm for punitive damages run amok. Despite awarding net compensatory damages of $108,000 in DAI's favor, the jury hit DAI with $1,000,000 in punitive damages on Substantial's Count II claim for "willful wanton breach of contract," a claim for which no actual damages were awarded. Recognizing that Illinois prohibits punitive damage awards for breach of contract, the Appellate Court loosely interpreted Count II as stating a claim for fraud, even though Substantial voluntarily dismissed with prejudice its fraud claim in Count IV, which was based on the same facts. The Appellate Court's end run of Illinois law is indefensible, particularly because DAI's conduct in this case was neither outrageous nor malicious and did not warrant punitive damages.

In *Pacific Mutual Life Ins. Co. v. Haslip*, 499 U.S. 1, 18 (1991), and *TXO Production Corp. v. Alliance Resources Corp.*, 113 S. Ct. 2711, 2720 (1993), this Court stated that "general concerns of reasonableness . . . enter into the constitutional calculus" when evaluating whether a punitive damage award violates the Due Process Clause. The Court should grant this petition to clarify that standard and give lower courts guidance in employing it. This case affords the Court an opportunity to make clear a basic due process restraint on punitive damages: an award of actual damages is a prerequisite to punitive damages. The petition also affords the Court an opportunity to confirm that punitive damages are reserved for outrageous or malicious conduct that merits financial punishment.

1. Although the Court in *TXO* suggested that a gross disparity between actual and punitive damages does not, by itself, establish a due process violation, the trial court

in that case awarded $19,000 in actual damages. *See* 113 S. Ct. at 2721-22. In this case, the jury awarded Substantial zero actual damages for Count II, but $1,000,000 in punitive damages. A party should not be financially punished for conduct that caused no injury.

Under Illinois law, an award of actual damages is a prerequisite to recovery of punitive damages. *See, e.g., Kemner v. Monsanto Co.*, 217 Ill. App. 3d 188, 199-201, 576 N.E.2d 1146, 1153-54 (5th Dist.), *appeal denied*, 142 Ill. 2d 655, 584 N.E.2d 130 (1991); *Rhodes v. Uniroyal, Inc.*, 101 Ill. App. 3d 328, 427 N.E.2d 1380 (3d Dist. 1981). Despite that rule, the Appellate Court ignored the jury's failure to award actual damages on Count II.

The jury's award of $200,000 in actual damages on Count I was for a purely economic loss stemming from breach of contract; it cannot sustain the punitive damage award. Plaintiffs in Illinois may not recover punitive damages for breach of contract. *See Morrow v. L.A. Goldschmidt Associates, Inc.*, 112 Ill. 2d 87, 94, 492 N.E.2d 181, 183 (1986).

Substantial tried to bypass that roadblock by labelling Count II as a claim for "willful wanton breach of contract." However, "[s]imply characterizing a breach of contract as 'willful and wanton' does not change the fact that plaintiffs are only seeking recovery for harm to a contract-like interest." *Morrow*, 112 Ill. 2d at 98, 492 N.E.2d at 185. The Appellate Court's reading of Count II as stating an independent tort claim for fraud is directly contrary to the Illinois Supreme Court's decision in *Morrow*.[1]

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[1] The Appellate Court also ignored the dismissal with prejudice of Substantial's claim for fraud in Count IV, which was based on the same facts as Count II. That dismissal constituted an adjudication on the merits and collaterally estopped Substantial from seeking damages for fraud. *See, e.g., Morris v. Union Oil Co.*, 96 Ill. App. 3d 148, 156, 421 N.E.2d 278, 284 (5th Dist. 1981).

2. DAI's conduct in this case did not justify punitive damages. In *Haslip*, this Court upheld an award of punitive damages for " 'intentional malicious, gross, or oppressive fraud.' " *See* 499 U.S. at 23. In *TXO*, the Court upheld an award for a "malicious and fraudulent" scheme that "was part of a larger pattern of fraud, trickery and deceit." *See* 113 S. Ct. at 2722. Similarly, in Illinois punitive damages may be awarded only when necessary to punish and deter " 'conduct involving some element of outrage similar to that usually found in crime.' " *Loitz v. Remington Arms Co.*, 138 Ill. 2d 404, 415, 563 N.E.2d 397, 402 (1990) (quoting Restatement (Second) of Torts § 908, comment b (1979)). DAI's conduct does not fit any of those descriptions.

DAI's statement that it would not unreasonably withhold site approval was not fraudulent. Generally, "to establish fraud the plaintiff must prove that the defendants misrepresented an existing or past fact; a promise to do something in the future is insufficient to establish fraud." *Sorkin v. Blackman, Kallick & Co.*, 184 Ill. App. 3d 873, 880, 540 N.E.2d 999 (1st Dist. 1989). No evidence in the record indicated that DAI, at the time it entered the franchise agreements with Cox and Yates, intended to withhold site approval unreasonably. It is contrary to DAI's financial interest to withhold site approval unreasonably, since the bulk of DAI's income comes from royalties.

Moreover, DAI had legitimate reasons for withholding site approval. DAI refused to approve the Mid-Rivers Mall site because a Subway franchisee with a shop across the street from the Mall threatened to sue DAI for encroachment. Although DAI's franchise offering circular stated that franchisees do not have exclusive territorial rights, the threat of a suit was not hollow. Numerous suits have been filed against franchisors alleging improper encroachment into a franchisee's territory. *E.g., Scheck v. Burger King Corp.*, 756 F. Supp. 543 (S.D. Fla. 1991),

recons. denied, 798 F. Supp. 692 (S.D. Fla. 1992); *Photovest Corp. v. Fotomat Corp.*, 606 F.2d 704 (7th Cir. 1979), *cert. denied,* 445 U.S. 917 (1980). DAI's decision to withdraw approval was not outrageous or malicious.[2]

DAI's representation that it would resolve disputes through arbitration was not fraudulent. To the contrary, consistent with the franchise agreements, DAI unsuccessfully moved to compel arbitration after this action was filed. DAI's designee, Subway Sandwich Shops, Inc., did not file the forcible detainer actions until several months after Cox and Substantial ceased paying royalties and advertising fees, and after Cox notfied DAI in writing that he had terminated the franchise agreements. Since Cox and Substantial continued to operate under the Subway name, DAI had a legitimate interest in protecting its trademarks. The jury and trial court agreed, awarding DAI more than $300,000 in actual damages and a permanent injunction. DAI's efforts to evict Cox and Substantial in no way justified an award of punitive damages, particularly since the forcible detainer actions were dismissed before the trial.

DAI is not contending that procedural safeguards against excessive punitive damage awards are so lacking in Illinois that all punitive damage awards violate due process. *Cf. Haslip,* 499 U.S. 19-23. The point is that the procedural safeguards in Illinois utterly failed in this case. The Due Process Clause demands more than the illusory protection DAI was afforded.

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[2] DAI refused to approve the Granite City site after Cox and Yates violated the franchise agreements by opening a competing Sub-City shop in the Mid-Rivers Mall. It was reasonable for DAI to refuse to engage in further dealings with Cox and Yates at that point.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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